

Testimony of Don Hall, Jr.
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Good morning, Chairman Blair, Commissioners Goldway, Hammond and Acton, and PRC staff. I am Don Hall, president and CEO, of Hallmark Cards, Incorporated, here in Kansas City. I am pleased you have chosen to come to the nation's heartland as a site for your field hearings, and I should add, "Welcome home to you, Chairman Blair and Commissioner Hammond."

I am eager to share my thoughts with you today along with the other panelists, all of whom have important points of view for you to consider. You have been given an important responsibility – one that will have far-reaching consequences for all of us in the mailing community. I believe that implicit in your responsibility is continuing the charge "to bind the nation together" through its correspondence, and I wish you well in that endeavor.

My situation is a bit different from my fellow panelists. I am here today, not as a mailer but rather on behalf of "the citizen mailer." The Greeting Card Association, of which Hallmark is a member, represents the interests of the individual or citizen mailer both formally in rate cases and in informal discussions with the Postal Service. We are the only independent mailing industry group that has assumed this responsibility.

Certainly, part of our motivation to play this role is that an affordable single piece first class stamp rate makes it more likely that folks will continue to rely on the mail stream as the primary means of sending our products. The greeting card industry represents a significant portion of the first class mail volume. We estimate that of the 40 billion pieces of single-piece First Class Mail sent each year, at least 10 percent is comprised of our industry's products, the mail which the

American public has stated they value the most.. Greeting card usage is nearly universal. Our household penetration is estimated at 88 percent, with the average household sending in excess of 30 cards per year. Of equal importance, however, is our desire to foster a culture that embraces personal expression and social connection. This is central to our mission. Not incidentally, this is also what the Postal Service was all about when it was originally conceived (binding the nation together), and what it continues to be even under the new legislation.

A central theme I want to leave with you is the notion of inter-dependence. Greeting card manufacturers' current business models are dependent upon our customers' ability to send and receive correspondence to any address at affordable rates. Similarly, I would argue that the fortunes of all postal customers are linked to one another. No longer can any class of mail either be considered dispensable or be taken for granted when rates or services are up for review. That is true for advertising mail and it is still true for the single piece mailer.

Let me take a moment to explain why the personal correspondence component of the First Class category is and will continue to be so important. To truly understand this, we need to look at mail from the viewpoint of the recipient. Simply put, people like receiving personal correspondence in addition to other highly valued material like magazines and online purchases. This fact is one of the major reasons why the Postal Service enjoys high regard, or "brand equity" with its consumers. In fact, this high standing with the general public may be the Postal Service's most valuable intangible asset. It is that ability -- to bring a gratifying "mail moment" to every American's doorstep -- that has allowed mail advertising, regardless of class, to be an effective medium. And I would argue that it will continue to be an effective medium only to the extent that personal communications continue to be a significant part of the overall mail stream.

The GCA so firmly believes in the notion of interdependence that we are participating in efforts to oppose these state-law "do not mail" initiatives that target ad-

vertising mail. We realize that personal correspondence cannot survive as an effective channel without advertising mail volume. It is my sincere hope, however, that decision makers within the Postal Service, the PRC and the wider mailing community will recognize that the converse is equally true. For mail to remain viable and valuable, consumer generated content must remain a meaningful part of the mix.

With that theme in mind, I'll turn to the specific questions posed to me when I received the invitation to appear before you today. They were: (1) what do we hope the new ratemaking system will look like, and (2) what expectations/hopes does Hallmark have for the "modern" service standards and goals the Postal Service is now required to develop.

Timetable for Action

What may be most striking about the new statute is that, after years of effort, Congress finally arrived at a bill that nearly every stakeholder could support. That does not mean that each group is equally enthusiastic for each main feature of the new Act. Some look for protection of their interests to the price cap and the Postal Service's newly enhanced pricing flexibility. Others expect to rely on the regulatory protections provided by other key sections of the law. What this diversely-based consensus means for the Commission, however, is that none of the principal statutory mechanisms can be postponed, neglected, or minimized. We hope the Commission will move quickly on all of them – preferably in this rulemaking, but in any case as soon as you can.

New Ratemaking System

Hallmark endorses the reply comments filed by the Greeting Card Association, in which the GCA addresses the following key sections of the new law: the price cap, the exigency provision governing above-the-cap increases, the work sharing

discount provisions, the reporting and annual compliance review mechanism, and the complaint provisions, as well as guidance on the treatment of confidential data. I understand that some commenters have urged the Commission to concentrate on setting up the price cap and to postpone what I call other "key sections." To us that would be in conflict with the history and policy and spirit of the new Act. Congress meant all these mechanisms to work together to achieve the difficult combination of business flexibility for the Postal Service and adequate protection for those who rely on it and on the public service mandate it exists to carry out. Let me use the complaint process as an illustration.

Complaint Process

To give the Postal Service the hoped-for flexibility, Congress substantially abolished before-the-fact review of rates. Many think the brief review the Commission is to give proposed rates before they go into effect is meant to check compliance with the price cap and nothing more. Whether or not that is true, the fact remains that the Postal Service is still a monopoly -- a vital and very complex one. Speed and flexibility in marketing and pricing are important, but so is protection for consumers, small businesses, and others who depend on postal communications but are not in a position to negotiate rates in advance. The complaint process is there to backstop the price cap and to insure that it is applied not only with mathematical exactness but also in a just and reasonable manner. You are charged with creating a system that will both provide pricing flexibility for the Postal Service and establish and maintain a just and reasonable rate and classification schedule. The consensus was that full prior review of rates would be incompatible with pricing flexibility; so the solution has to be a power in the Commission to provide after-the-fact remedies if rates established under the price cap turn out to be something other than just and reasonable.

For that reason, the Commission needs to move quickly on establishing rules for the complaint process and the other backstops to the price cap system.

I am far from suggesting that you need to solve, in advance, every problem and enact every definition that use of the complaint and the other mechanisms will eventually make relevant. While there are some principles of interpretation that would be useful and appropriate to adopt at the outset, my first focus would be on creating the procedures necessary to make these mechanisms available and to insure that if properly invoked they will provide meaningful relief. For example, the Commission will need to develop a speedy but effective trial procedure for complaints. It is likely that a set of rates under the new Act will last for only a year or two, at least for most classes of mail. To be fair both to the complainant and to the Postal Service – which needs to know whether its next planned set of rates may also be subject to legal objections – it would be helpful to have the complaint decided before the rate cycle ends. Probably the Commission will want to devise procedures that eliminate the weeks of oral hearings that characterized the former rate case process. If there is a way to cut down the reams of written interrogatories, I am sure that would be a helpful and welcome development too – though it probably means providing some expeditious means of access to otherwise confidential data. And I hope the Commission would also clarify what a complainant needs to show, first, in order to raise a “material question” of law or fact, and, second, to establish – once its complaint has been accepted as raising such a question, and a proceeding is scheduled – that the complaint is “justified.”

“Just and Reasonable” Standard

One of the most significant continuities between the old statute and the new one is that the ratemaking system still aims at establishing and maintaining an appropriate schedule of rates and classifications. I stress “schedule” because it means that when the Commission examines rates – in an annual compliance review or a complaint case – those rates have to be considered in relation to each other and not just piecemeal. The new law requires the schedule of rates to be “just and reasonable.” No doubt the differences between that standard and the “fair and equitable” standard of the 1970 Act will become clearer with experience. It is

less important today to speculate about what they might be than to realize that both the old and the new statute still require that rates be looked at as an integrated "schedule," which must be just and reasonable when viewed as a whole. GCA, of course, made this point in its written comments. I bring it up now because I understand that some comments filed with the Commission misunderstood it: they took GCA to be arguing that the new "just and reasonable" language itself meant the same as "fair and equitable." I am sure the new terms do not have the same meaning – otherwise, why would Congress have changed the old ones? But it is wrong to conclude that they have no meaning. We have faith in the Commission's ability to detect and remedy patterns of discrimination or injustice in the rate schedule based on the "just and reasonable" requirement.

Exigency Requirements

As I have said, the complaint and similar mechanisms are backstops and a safeguard surrounding what is certainly the main ratemaking mechanism – the price cap. Because it will, in practice, be the main mechanism, it is important that it be effective in and of itself. Two areas in which early Commission guidance is needed to make it inherently effective are the "exigency" provision for rate increases exceeding the cap, and the question of how the Postal Service may use "banked" rate authority.

The new Act specifies that the Postal Service may accumulate retained earnings. They are part of the "adequate revenues" by which the Service is to maintain its "financial stability." If the price cap is to be a meaningful constraint on rates, these retained earnings (and any appreciation of them) should be the first line of defense against unanticipated cost increases or external adversities such as the post-9/11 anthrax scare. The Service must balance the constraints of the price cap, its own need for operating and investment funds, and the likely effects of rate increases on the willingness of its customers to go on using the mail. The remarkable success in cost reduction which the Service has recorded under the leadership of Postmaster General Potter gives me confidence that the Service

will not have to rely on frequent exigency increases. But if the exigency provision is over-used, mail users in all classes will have to conclude that the price cap scheme is not going to succeed – and, as the Act also provides, after 10 years this Commission will have to devise something better.

Banking Authority

I spoke just now of balancing the need for funds against customers' reactions to rate increases. Another way in which the Service can do this is by using the "banking" provisions, which allow it to use in a later year a quantum of rate increase authority which it chooses not to use in the current round of new rates. But this mechanism, too, must be used with appropriate caution. In particular, the Commission can help harmonize it with other requirements of the statute by clarifying that banked rate authority originating with one class of mail cannot be applied in a later year to increase rates in a different class. This seems to follow from the clear directive in the Act that the price cap is to be applied on a class-by-class basis. If, for a given class, the price cap can be exceeded – and, particularly, if it can be exceeded year after year – by merely raising some other class less than the cap, then this directive will have been badly compromised. And, more generally, there will be grounds to find that the rate schedule as a whole is no longer "just and reasonable."

Like most mail users, we hope the price cap fulfills Congress's expectations. We do not want to see either runaway rates, harmful inter-class distortions in rate relationships, or – should the price cap fail to produce the results expected of it – a reversion to the litigation-dominated process of the last 35 years. But the price cap is just one part – though perhaps the most revolutionary part – of a complex, interdependent enactment. I believe it cannot work to our general satisfaction if the backstops and safeguards I discussed earlier are not made effective along with it, and if the qualifications to it – the exigency and banking provisions – are not assigned their proper roles by clear guidance from the Commission.

Efficient Component Pricing

At this point, I would like to narrow my focus somewhat and turn to a special issue in First Class Mail. It concerns the relationship between rates that our customers pay to send greeting cards as single-piece mail and the rates for bulk work shared First-Class letters.

I do not propose to delve into the details of "efficient component pricing," although there seem to be some differences of opinion as to just what it means. But the Commission has consistently been careful to distinguish the actual savings produced by substituting private-sector for Postal Service operations from the cost difference caused by certain inherent characteristics of the mail that are simply more prevalent in bulk mail than in single-piece. We hope that rates under the new statute will continue to reflect that way of thinking, and that the system the Commission is creating will encourage the Postal Service to design its rate proposals accordingly. We recognize that the postal market is too complex and full of unknowns to allow theoretically perfect realization of any ratemaking theory. The new Act, however, recognizes this distinction in the provisions governing work share discounts. And indeed it seems to be a matter of common sense as much as economic theorizing: for me, as a businessman, there is no point in offering a "work share" discount that does not actually result in reducing the work I have to pay for.

This is particularly important at a time when First-Class Mail, which still pays well over half the Postal Service's institutional costs, is under siege from alternative media. Under these conditions, it is vital to preserve or increase all First-Class volume rather than unduly favoring one type over another. If it succeeds in doing this, the Postal Service can both maximize contribution to its institutional costs and serve the general public interest.

Service Standards

The requirement for the Postal Service to develop and abide by service standards for its products was a welcome and important provision of the Postal Accountability and Enhancement Act (PAEA). It is critical for all mail users to have an understanding of the standard of service they are entitled to receive and for the Postal Service to be held accountable to those standards. Fortunately, for single piece First Class Mail users, standards of service have been established for some time and a system of measuring performance against those standards has also been implemented¹. While many mail users find themselves in the position of having to create standards and metrics from whole cloth, the challenge for those concerned with single piece First Class Mail is to preserve the standards already in place and to seek improvements to the process where possible.

It is the position of the greeting card industry that there should be no diminution of the current service standards for First Class Mail either in terms of the stated length of time for a mail piece to be delivered across the various regional distances or in the regions themselves. The industry also believes that the EXFC system should be broadened to include mail pieces that are not being counted. Currently, only mail pieces that bear complete (and completely legible) address information are included in the performance measurements. We think that the data should reflect all mail pieces that contain at least the minimum amount of information prescribed by the Postal Service as necessary for delivery. Clearly, the inclusion of such mail pieces will have an impact on the numbers, however,

¹ (Service Standards as set forth in Witness Pranab M. Shah's R-2006-1 Testimony: Overnight: All of the intra SCF area plus certain high volume areas within reasonable reach of surface transportation; 2 Day: All SCF areas outside of overnight area within the home state and nearby states within the reasonable reach of surface transportation. May include 3-digit areas outside of access to surface transportation if significant business/mail volume relationships exist and are with access to air transportation; and 3 Day: All remaining destinations.) EXFC is an external measurement system of collection box to mailbox delivery performance, focused on single-piece First Class. EXFC continuously tests a panel of 463 ZIP Code areas selected on the basis of geographic and volume density from which 90% of First-Class volume originates and 80% destines. EXFC is not a system-wide measurement of all First-Class Mail. Source: FY2006 Comprehensive Statement on USPS Operations, p. 68.

including only mail pieces that do not reflect the reality of the types of hand written addresses found in the real world provides a distorted picture of reality. Far more than the occasional inadequately-addressed letter is in issue. First-Class Mail, as I have noted elsewhere, now has nonpostal competition on a huge scale – for bill payments, bank account management, and the like. If service for strictly consumer-originated mail is allowed to deteriorate, it will be a powerful incentive for consumers to shift their transaction mail to the Internet. That is one important reason why the issue of inclusiveness is really the primary concern of the greeting card industry in the whole issue of standards and metrics.

The greeting card industry has been participating in the Mailers Technical Advisory Committee (MTAC) working group tasked with the process of developing service standard recommendations intended to fulfill the requirements of the PAEA. While the process is moving forward, we have been concerned with some of the recommendations of working group participants that suggest that smaller volume mail types such as non-machineable mail pieces should not be measured in deference to higher volume mail categories. I strongly disagree with this type of approach. Nowhere in the language of the PAEA is there a suggestion that any of its provisions were to be applied selectively based on volume. All mail users are entitled to the provisions and protections of the act. The individual mailer of a non-standard size greeting card and the home business owner sending a parcel in fulfillment of an order from E-bay are both every bit as entitled to have an expectation of what service their mail piece will receive and to know how well the Postal Service is doing in meeting those expectations as the sender of several thousand presort First Class mail pieces.

Having said this, the greeting card industry understands that the needs of mailers differ and that any measurement system must be as cost effective as possible. I would submit that whereas a business First Class presort mailer might need access to service performance information on an extremely frequent basis, the citizen mailer would be satisfied with an annual accounting of performance. What is

critical, however, is that every mail type be measured. To the sender, the most important mail is that which he has put into the system. There is no distinction based on volume in the mailer's mind and there should be none in the system of standards and measurements. The concept of equal protection under the law is fundamental to our democracy and the PAEA provides no volume-based distinctions in its requirement for service standards. This means not only that the standard should be the same for one piece or a million-piece mailing, but also that we should know, for both types, how well the standard is being met. Accordingly, I would strongly urge that no distinction be inserted artificially into the process.

At the same time, the complexity and cost associated with the measurement of different types of mail need not be the same. I am confident that a less costly sampling measurement method could be developed to provide useful data at a reasonable cost. One size need not fit all in this regard.

This issue is of concern to the greeting card industry. The PRC should be well acquainted with the importance of one particular type of non-machineable single piece First Class mail, the square greeting card. The GCA testimony in the most recent rate case discussed the importance of these mail pieces at great length and I will not repeat it here. Suffice it to say, however, that given the importance of these types of cards to our customers, a reliable measurement of how well these mail pieces are making their way through the system is equally important. Other niche users of the mail such as those sending small parcels in fulfillment of on-line orders as referenced above are equally important. The GCA will continue to work in the ongoing process at MTAC to ensure that no mail pieces are left out of the measurement process; and I sincerely hope the Commission will keep our views in mind when evaluating the final proposal for Service Standards.

Conclusion

I appreciate this opportunity to respond to the questions you have posed. Let me close by reiterating Hallmark's key concerns as you complete your work in implementing the PAEA. I believe everyone concerned with the Postal Service must acknowledge the interdependence of all types of mail and recognize that none can be considered dispensable. As you go about this task, I urge you to work concurrently on all the requirements of the PAEA. Given that they all will interact with one another, it is important to have each subsystem in operation at the point the entire system is implemented.

Given the profound ramifications for mailers of the task set before you, it is vital that a robust and effective complaint system be implemented to provide opportunities to correct any problems that might arise. We trust that the Commission will be able to evaluate the schedule of rates put forth by the Postal Service and over time make sure that no patterns of discrimination or injustice occur.

It is imperative that the Commission clarify what circumstances warrant the rate cap to be pierced and to make certain that the Postal Service exhaust all other resources provided by its ability to retain earnings before seeking rate increases above the cap. In addition, I urge the Commission to take steps to make certain that workshare discounts offered under the new system truly reflect costs avoided to the benefit of the Postal Service.

Finally, the citizen mailer is fortunate that service standards and a system of measurement are already established for First Class Mail. Our goal is to make sure the existing standards are not diminished and to expand the system of measurement to cover a broader sampling of mail to account for non-standard shaped mail pieces and addresses.

Thank you for your time and consideration of these thoughts as you finalize the new ratemaking system and to reinforce the current service standards.

I hope that your time in Kansas City has been well spent and that you find some time to enjoy some of our areas nationally recognized barbeque.